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C O N F I D E N T I A L SECTION 01 OF 03 ANKARA 001727

SIPDIS

TREASURY FOR INTERNATIONAL AFFAIRS - MMILLS AND CPLANTIER
NSC FOR BRYZA AND MCKIBBEN

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TAGS: [EFIN](#) [TU](#)

SUBJECT: MOVEMENT ON IMF CONDITIONS HELPED BY MARKET
SELL-OFF

REF: A. ANKARA 1559

[1B](#). ANKARA 1318
[1C](#). ANKARA 1093
[1D](#). ANKARA 812

Classified By: Economic Counselor Thomas C. Goldberger for reasons 1.4(
b) and (d).

[11](#). (SBU) Summary: The GOT has re-energized its efforts to complete the prior actions needed to finalize its IMF new program. Following a recent sell-off in Turkish markets, the GOT seems to be moving on the three prior actions: Tax Administration Reform Law, Banking Law and Social Security Reform Law. Though Minister Babacan has publicly explained he need for an IMF mission to come back in April, and is hoping for agreement on a Letter of Intent by mid-April, resolution of the expanded regional investment incentive issue and compensating measures could push conclusion of an LOI to a later date. End Summary.

A Re-energized Effort on Prior Actions

[12](#). (SBU) After three months of excruciatingly slow movement on the prior actions required to complete the Letter of Intent, the GOT appears to have been roused to action in recent days. Two economic officials who serve on the GOT negotiating team with the IMF separately confirmed press reports that the GOT is trying to speed things up. These officials, while not certain of what changed after months of inertia, agree with press claims that the GOT was worried by the market sell-off during the week of March 14 and correctly feared that a Federal Reserve rate hike would unleash a round of selling. On March 23, Central Bank Governor Serdengeceti made his bluntest public warning to date on the need for the GOT to finalize the IMF program, saying the longer the IMF program is delayed "the more dangerous I would find it." Reading between the lines of the officials' comments, Minister Babacan, who had been unable to convince the Prime Minister to take decisive action in January and February, used the sell-off to galvanize the Cabinet and Prime Minister to action on the prior conditions.

Social Security

[13](#). (C) Perhaps the best example of this was the announcement that the Social Security Reform Law, which had been stalled for months, was "open for signature" at the Council of Ministers. (When laws are opened for signature, all the staff work below the ministerial level has been completed and all that remains is Council of Ministers approval. It does not necessarily mean that disputes between ministers have been resolved since laws that have been opened for signature are sometimes changed.) State Planning Organization Deputy Undersecretary Birol Aydemir confirmed to Econoff that the Prime Minister has made the necessary--and politically-difficult--decisions on which parameters (retirement age, valorisation of rights, indexation of payments, etc.) will be altered by the law. Aydemir said that the PM's decision came following a series of meetings with Ministers Babacan and Minister of Labor Basesgioglu.

Tax Administration

[14](#). (C) The Tax Administration Reform Law, the only law which the IMF is requiring be passed by Parliament as a prior action (the others only need to be submitted to Parliament) was approved by Council of Ministers and submitted to Parliament in late February. Unfortunately, the same issue that split the Council of Ministers has reportedly spilled over into the Parliamentary debate, with the Budget Committee sending the bill back to sub-committee for further work earlier this month. The dispute pits the Board of Accountants and powerful alumni such as Minister Unakitan,

Tax Administration Director General Arioglu and Finance Ministry Undersecretary Basri Aktan against the Tax Controllers and their alumni such as Deputy Prime Minister Arioglu. The issue relates to the special status of these two groups and their respective roles in tax auditing. Aydemir confirmed, however, that the GOT is urging parliamentarians to speed up their work on this law.

Banking Law:

15. (SBU) The Banking Law, which had been opened for signature several weeks ago, continued to be the subject of contention, as Bank Regulatory and Supervisory Agency (BRSA) Chairman Tevfik Bilgin fought a rearguard action against two aspects of the bill that the IMF had insisted on. The two issues are: a) allowing the Savings Deposit Insurance Fund (SDIF) the flexibility not to liquidate a bank immediately after a takeover; and b) ending the Sworn Bank Auditors' monopoly on on-site bank inspection. As with the Accountants Board/Tax Controllers issue, Bilgin's ferocious opposition has everything to do with his defending the privileges of his fellow Sworn Bank Auditors and little to do with policy. On March 21, Deputy Prime Minister Sener overruled Bilgin and insisted on keeping the IMF's demands in the law, at which point Bilgin asked for a meeting with the Prime Minister. Bilgin is expected to appeal to the Prime Minister about the law and there is speculation Bilgin will resign if his appeal fails. Once Bilgin has his meeting, the law can reportedly be approved by the Council of Ministers and submitted to Parliament.

Babacan on Timing

16. (C) In an interview on CNN-Turk March 23, Babacan explained that an IMF team would need to come to Turkey to update the LOI, since more than three months had passed since broad agreement was reached on a draft LOI. In what may have been an effort to create some deadline pressure, Babacan went on to say that the GOT should be able to reach agreement with Fund staff on a LOI before the Spring IMF/World Bank meetings in mid-April. However, the Turkish Treasury Department Head who coordinates work on the IMF program, admitted to econoff that the LOI will probably take longer to complete. Demirkol agreed that, even if the Government pushes through the three prior actions in the next week or two, the IMF team's work on revising targets, deadlines and projections, coupled with resolution of the regional investment incentives scheme issue and compensating fiscal measures are likely to take time. On the other hand, Birol Aydemir claimed that the investment scheme issue would not drag things out and chuckled that he and his colleagues have become adept at working out compensating fiscal measures quickly, as they have done several times in negotiations over IMF reviews.

Regional Investment Incentives:

17. (SBU) Though the original, costly version of the expanded regional investment incentives scheme--the version the IMF insists it cannot accept--was long ago submitted to Parliament--both Turkish officials and the IMF say that the GOT has agreed to instruct Parliament to change the text to a much less costly version that would narrowly target only newly-created jobs. Aydemir said that the economic bureaucracy, with the approval of Babacan, have drafted such a proposal, but that the Prime Minister still needs to approve it before Parliament can get its revised marching orders. Aydemir insists the IMF is way off on its estimates of what the revised version would cost, with Aydemir claiming it would cost only \$50-60 million per annum, an amount for which it will be easy to find compensating measures.

Comment:

18. (C) It may be that Aydemir's confidence about finding compensating measures is linked to increasing GOT confidence that Turkey will overperform on its fiscal targets in 2005: Minister Unakitan recently crowed about the overperformance in January and February and Babacan noted in his CNN-Turk interview that the 2004 primary surplus reached 6.9%. Outside observers, however, do not count on the continuation of fiscal overperformance, for two reasons. In 2004, Turkey overperformed in the first half of the year, while performance lagged near the end of the year. This year, economists outside the government also worry that expected slower growth will hit revenue collection hard, particularly since about 70% of collections come from indirect taxes. It seems unlikely, therefore, that the IMF would accept gambling on fiscal overperformance and give the GOT a pass on

high-quality compensating measures for the investment scheme.

19. (SBU) The disagreement over the cost of the regional investment incentives lends credence to the view that it may take more time to reach agreement with the Fund. Moreover, both Ozgur Demirkol at Turkish Treasury and the IMF Resrep have told us the IMF will be very tough on the quality of the compensating measures, rejecting any cuts in the investment budget. Given that the GOT has repeatedly raised taxes, especially indirect taxes, in recent years, and that the Prime Minister is very keen to cut rather than raise tax rates, tax increases would not appear to be a likely source of compensating measures. This leaves only cuts in current spending, a politically difficult option for the Government with increasing rumors of early elections and a series of parliamentarians resigning from the AK Party. End Comment.

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